TVARS Chair Welcomes Call for Long-Term Strategy

BY LES BAYS

As Chair of the TVA Retirement System Board, I welcome Tom Kilgore's article, "Retirees' Financial Security Key Commitment of TVA," published in the June 2011 *TVARA News* and E-mailed as the May 26, 2011 *TVA Today Update*.

Perhaps most important to TVA retirees and employees should be the article's reaffirming TVA's commitment to TVARS.

Particularly, Mr. Kilgore writes that TVA's goal is to ensure that TVARS remains financially sound and able to meet commitments to all employees throughout their retirement years, that there should be no concern or question about TVA's commitment to retirees or TVA's determination to see the system restored to a strong financial footing, and that TVA wants to provide a retirement system that helps every employee enjoy a secure retirement.

Retirees today expect to maintain an active lifestyle for years, even decades, after retirement. To have the financial security we all want with retirement, having a fully funded retirement system is the top priority.

Next, inflation is one of the most significant risks to the financial security and enjoyment of our retirement. For this reason, the cost-of-living adjustments (or COLAs) built into TVARS benefits, as adopted based on a proposal by President Johnson's Cabinet Committee for Federal Plans in the mid-1960s, are an important part of securing our retirements.

For the years 1990 through 2007, TVARS was overfunded every year except 2002, 2003, and 2004, which occurred after the stock-market decline in 2001. Then the combination of the 2008 global economic meltdown and other factors left TVARS, along with most other pension funds, substantially underfunded.

The largest contributing factor to TVARS's underfunding, other than the declining stock-market and discount rates, was adding TVA requested benefits to the system. Additional benefits increased liabilities and contributed to today's underfunding. More than half (about 53 percent, as accumulated with interest as of September 2010) of the current almost $3.5-billion current (FAS 87)* underfunding results from TVARS adding three benefits:

* About 9 percent of the $3.5-billion (FAS 87) underfunding results from an incentive requested by TVA for workforce reduction;

* About 28 percent results from TVA's transferring responsibility for retiree medical-insurance premiums to TVARS (at a time the retirement system was significantly

overfunded, TVA stopped a retiree healthcare credit and TVARS agreed to create a vested benefit as a supplement toward medical-insurance premiums); and

* About 16 percent results from an additional supplemental benefit to assist with retiree medical-insurance premiums.

During the period TVARS was overfunded, TVA's transferring and TVARS's adding benefits made sense so, among other things, TVA could make investments elsewhere (as examples, investing in high-return projects such as getting nuclear plants online, fossil-plant life extension, hydro-plant modernization, enhancing the transmission system, and purchasing and building combustion turbines). A stronger TVA should be good for all TVA employees and retirees, as well as TVA's customers.

A contributing factor to the calculated change in TVARS's funding liability has been the actuarial assumptions used. Interest rates' dropping since the mid-1990s significantly affected the FAS 87 calculation of TVARS's funding, with the discount rates used changing from around 8 percent to as low as 5 percent today. If interest rates increase in the future, that would improve TVARS's calculated underfunded liability.

Another major contributing factor to the system's current underfunding could be seen as TVA's not contributing to TVARS for six of the years when TVARS was overfunded. Again, at the time, TVA's making investments elsewhere when TVARS was overfunded was not only defensible, but should still make sense in hindsight. TVA is now stronger and should be in a better position financially, after the unexpected 2008-2009 stock-market decline, to bring TVARS back to being fully funded.

While the 2008 global recession may be the largest contributing factor to TVARS's being underfunded, retirees and employees should be reassured that the investment performance of TVARS's assets has been exemplary. Compared to similar pension funds, which also hire professional money managers, the investment performance for TVARS assets has been in the top 25 percent over the past 10 years and was in the top 10 percent in 2010.

TVARS hires — after TVA approves — some of the best professional money managers in the world within each asset class. And in 2009, at TVA's request, TVARS added an investment professional to its Investment Committee to strengthen governance and oversight.

With hindsight, one can argue that TVARS, while overfunded, should have moved assets into investments with less risk to stock-market declines (but which would have been expected to have lower long-term returns). Pension funds that follow such a strategy were rare, though, and the strategy requires higher employer contributions due to the lower expected returns over the long term.

TVARS, a government retirement plan with a 30-year horizon built into the plan rules, has always had a long-term investment approach. Now, with TVARS's having two retirees for every active employee, perhaps reducing the investment risk and a shorter investment horizon are an appropriate approach. The TVARS Board is currently looking at different strategies that would gradually de-risk the investment portfolio, recognizing that such a strategy requires greater employer contributions.

Finally, the TVARS Board believes that one should always consider ways to improve. The TVARS Board has been working for several months toward implementing a written governance framework and processes. We hired a leading consultant in this area to provide advanced fiduciary training and to help us develop written policies to guide the TVARS Board in its actions and decisionmaking.

The TVARS Board is looking forward to working with John Thomas, TVA's Chief Financial Officer, to develop a long-term strategy that will continue to improve TVARS's governance and performance, and to helping prepare a white paper describing the background, current status, and future plans for the retirement system.

We appreciate TVA's commitment to funding to help restore employees' and retirees' trust in their retirement plan.

**TVA, as plan sponsor, is subject to Statement of Financial Accounting Standards No. 87 (FAS 87), Employers' Accounting for Pensions. This statement reports on the employer's pension obligation and requires a standardized method for measuring pension costs.*